

**CALIFORNIA GAMBLING CONTROL COMMISSION**

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Good Morning Mr. Chairman and Members of the Little Hoover Commission:

My name is John Hensley, I am the Chairman of the California Gambling Control Commission. Thank you for giving me this opportunity to speak with you today regarding a matter that may have significant policy implications on gambling in California, and in particular, on the viability of one segment of the gaming industry – the card club industry.

Before I get to that policy issue, I would like to give you a brief background about the California Gambling Control Commission, gambling and the regulation of gambling in the state, and then get to the question at hand – is the policy still valid that prohibits persons or entities that are engaged in gambling activities that are illegal in California from owning or operating card clubs in California?

#### Gambling Control Commission

The Gambling Control Commission was created in 1998 with the enactment SB 8 (Lockyer) and was officially constituted in September 2000, when Governor Davis made his initial appointments to the Commission. The Commission's budget was authorized in August 2001, after which, the Commission began to hire staff. The Commission represents one-half of the State Gaming Agency, along with its counterpart - the Division of Gambling Control which is housed in the Department of Justice.

In general, the Commission is charged with setting policy, issuing licenses, auditing, adjudicating, and regulating all matters related to gambling in the State of California. The Commission has jurisdiction over the operation, concentration, and supervision of gambling establishments in this state and over all persons or things having to do with the operations of gambling establishments. The Division's responsibilities include, in general, monitoring, investigation, and enforcement.

The Commission consists of 5 gubernatorial appointees representing specified disciplines and having specified experience:

- A certified public accountant with auditing experience
- An attorney and a member of the State Bar of California with regulatory law experience
- One member with a background in law enforcement and criminal investigation
- One member with a background in business with at least five years of business experience
- One member from the public at large

At this time, four of the positions have been filled and the public member position is vacant.

## Gambling in California

The need to have state regulators, such as the Commission and the Division, stems from the fact that gambling is a legal form of entertainment that people enjoy and participate in. Gambling in California dates back to the Gold Rush era and is a colorful part of the state's history. The images you might recall in western movies of saloons with gamblers sitting around a card table were a reality in the mid-1800's in California. Since that time, other types of gambling have been legalized in the state, such as paramutual wagering on horse racing, charitable bingo, the state lottery and gaming on Native American lands.

The trend in California is that gambling is on the upswing. Currently California ranks second nationally, behind Nevada and ahead of New Jersey, in the total gross revenue generated from gambling. Nevada generates approximately \$9 - \$9.5 billion annually, California generates approximately \$5 + billion annually, and New Jersey generates approximately \$4 + billion annually.

In the next seven years, California is projected to generate gross revenues of approximately \$9.5 - \$10 billion annually from gambling, putting it on par or possibly even surpassing Nevada. The growth is expected to be realized in tribal casino gaming. There are 108 recognized tribes in California. The state has entered into compacts with 61 tribes, of which 46 are gaming (there are 47 casinos because one of the tribes has two casinos). Growth is anticipated across the board, in those tribes that currently have and do not have gaming.

The card club industry, on the other hand, is declining. As early as seven years ago there were approximately 535 card clubs, now there are approximately 115. It is unclear if the number of card clubs will stabilize or continue to decline, but it is clear that its future will be dependent upon its ability to compete with other forms of gaming.

Gambling is a significant industry in California and it needs to be regulated to protect the integrity of the industry as a whole, whether its card club gaming, tribal gaming, etc., and to serve as a deterrent to organized crime. It is in the best interest of both the general public and industry to ensure that the public is safe, will be treated fairly, and won't be cheated when visiting gambling establishments.

To do this effectively, from a regulators standpoint, the laws governing gambling need to be adequate and consistent to the greatest extent possible among all gambling industries. They need to be adequate in terms of providing the regulators with the power and authority to take action to protect the public and keep gaming free of criminal and corruptive elements. They need to be adequate to ensure that the industry has the tools necessary to enable it to operate effectively and efficiently without being over-regulated. In addition, they need to be clear and consistent, to the greatest extent possible within the letter of the law, regardless if it is card room gaming, paramutual wagering on horse racing, or tribal gaming, to provide the greatest understanding of the rules by the general public, industry, law makers, and even regulators.

## Regulation of Gambling

California's regulatory scheme of card room and tribal casino gambling is modeled after the state of New Jersey's. It's a bifurcated system that generally houses the policy setting, license approval, auditing, adjudicatory responsibilities, and the adoption of regulations under a Commission and the investigatory and enforcement responsibilities under its Department of Justice.

The New Jersey Casino Control Commission consists of 350 employees and has an operating budget of \$25.2 million dollars. Aside from the number of employees and size of its operating budget, there is another major difference between the New Jersey Commission and California's Commission - the New Jersey Commission also has an investigation and enforcement unit. The reason is that in its role as a license approval or adjudicatory body, it may be necessary to conduct further investigations beyond that of the Department of Justice's efforts. In addition, the Commission cannot direct or force the Department of Justice to act on all matters, and therefore, it needed this capability in house.

The New Jersey Department of Justice also has a much more substantial staff size and operating budget dedicated for the regulation of gambling than does its counterpart in California. New Jersey's Department of Justice has 375 employees and an operating budget of \$34 million for gambling regulation and enforcement. Another significant difference between New Jersey and California is that New Jersey has state law enforcement officers housed in each casino.

In New Jersey, the state regulates 14 casinos in approximately a 3 square mile area (Atlantic City). In California, the state regulates approximately 160 establishments (card clubs and tribal casinos) that are spread out across the entire state.

By comparison, the California Gambling Control Commission has budget authorization to hire 34 staff + five commissioners. It currently has 24 staff (including Commissioners) and an annual operating budget of approximately \$4.7 million.

The Division of Gambling Control has over 150 employees and an annual budget over \$14 million annually. From 1984 (when the Gaming Registration Act became operative) until the constitution of the Commission in September 2000, the Division was the state regulator responsible for the regulation and enforcement of card room and tribal gaming in California.

## Gambling Control Act

In general, the Gambling Control Act (Act) governs the regulation and enforcement of gambling in card clubs throughout California. The Act (as well as the state Constitution and the Penal Code) gives the state the authority to determine what types of non-house banked games are acceptable, the card clubs hours of operation, who may be involved with the financing and operations of gambling establishments, and it establishes the powers and authority of the

Commission and the Division for the regulation and enforcement, respectively, of card room gambling in the state.

The governance of card club gambling in the state in many cases is shared among the locals and the state. Many local jurisdictions have adopted ordinances that allow for card club gaming. The local ordinances establish what types of non-house banked games are acceptable, the hours of operation, and who may be involved with the financing and operations of gambling establishments.

The state and local agencies require card clubs to pay fees to cover regulatory costs, among other things. The costs of state regulation are borne solely on fees and are not offset in any manner by the state's General Fund. The fees paid to local jurisdictions, on the other hand, pay for regulation, among other things, and are particularly beneficial to some local communities municipal budgets.

#### Tribal-State Compacts (Compacts)

Regulation of tribal casino gaming is shared among the respective tribes, the federal government and the state. With respect to the state's authority under the compacts, the state has authority to make findings of suitability on the persons involved in the gambling operations, financiers, and gaming resource suppliers. The tribal gaming agency considers the state's recommendations in making its decisions in these areas. In addition, the National Indian Gaming Commission has the authority to approve tribal casino management contracts, among other things, although it appears that greater coordination between the state and federal regulators may be beneficial to ensure that the contractors adhere to state laws, such as registering with the Secretary of State.

The tribal gaming agencies make contributions into two funds, the Indian Gaming Special Distribution Fund (SDF) and the Indian Gaming Revenue Sharing Trust Fund (RSTF). Fees paid into the SDF are based upon the average net win on slot machines in service prior to September 1, 1999. The payments, which are expected to commence approximately in July 2002, are subject to appropriation by the Legislature for specified purposes, including, but not limited to, state regulation, mediation of state and local agency impacts, and gambling addiction programs. The SDF is based upon revenue from approximately 14,000 + machines. This number is fixed and will not grow.

Payments in the RSTF are based on fees paid for slots machine licenses acquired after September 1, 1999. The funds are collected by the state and distributed equally to non-compact tribes, up to a maximum of \$1.1 million a year. The state takes no share of these monies for any purpose. The state collects the money, performs administrative functions, prepares distribution reports for approval by the Department of Finance and the Joint Legislative Budget Committee, and authorizes the Controller to release payment. Based upon current license counts and payments into the RSTF, the amount paid per tribe (which includes gaming tribes with less than 350 machines) will fall well below the \$1.1 million cap.

## Comparison of State's Authority Under the Act and Compacts

In general, the state has greater authority over card club gaming than it does over tribal casino gaming. The state's regulatory role over card clubs could be considered one of a more traditional relationship between the regulator and the regulated. Powers and authority are specified in statute and the state's ability to regulate and enforce the laws are clear and direct.

The compacts, on the other hand, are contractual agreements between the Governor and sovereign nations. Since regulation of gaming is shared among the state and the respective tribal gaming agencies, regulation is much more process oriented respecting the roles and responsibilities of the respective governments.

The goal of government is to assure that laws and regulations are adequate to ensure gaming is conducted fairly, safely, and free from corruptive and criminal elements.

## Purpose of Hearing

Last year, the Governor vetoed SB 51 (Vincent), a measure that would have created a narrowly crafted statutory exemption to allow a publicly traded corporation that leases a card club from a publicly traded racing association to obtain a state gambling license. The bill further would have required that the card club must have been in continuous licensed operation within the enclosure of the publicly traded racing association's racetrack prior to and after July 1, 2000.

Under existing law (Business and Professions Code Section 19848.5), state gambling licenses generally may not be issued to business entities, partners, directors, officers, or shareholders that have a financial interest in any business or organization engaged in forms of gambling that are prohibited in California, whether conducted within the state or elsewhere. Existing law contains various exemptions, including an exemption for publicly traded racing associations (SB 100 (Maddy, Chapter 387, Statutes of 1995)).

In its enrolled bill report on SB 51, the Commission suggested to the Governor that it may no longer be good public policy to prohibit business entities that own out-of-state casinos from operating card clubs in California. Pursuant to this suggestion, the Governor asked the Little Hoover Commission to examine the policy underlying this prohibition and report back its recommendations. This is where we are today.

In addition, other legislative measures are being considered by the Legislature that brings the underlying policy into question. SB 1413 (Vincent, 2002) is nearly identical to his SB 51 that was vetoed last year. In addition, Assemblyman Firebaugh authored a measure, AB 572 (2001), that would authorize a publicly traded corporation to be eligible for licensure as an owner in no more than two card clubs provided the corporation meets the applicable eligibility and licensing provisions of the Gambling Control Act of 1997 and any other requirements established by the California Gambling Control Commission.

Further fueling the debate is the fact that tribal gaming is not subject to any similar restrictions respecting tribal casino “gaming resource suppliers” (defined in the Tribal-State Gaming Compact, section 2.12), financial sources, or operators. For instance, publicly traded corporations that own and operate casinos in other states also manage and/or finance the operations of tribal casinos in California.

In addition, as mentioned earlier, the number of card clubs operating in California is in decline. This is an industry that contributes more than one hundred million dollars in taxes and fees to California’s governments (Business and Professions Code Section 19801). This is vital to the economic viability of some communities. If it is the state’s policy to assist in the livelihood of this industry, it should consider extending to the card clubs some of the same business tools that it affords tribal casinos provided it is in the public’s best interest to do so.

To the Commission, that is the most important question at hand. Is it in the public’s best interest to remove the prohibition to keep business enterprises that are engaged in gaming activities not authorized in California from owning or being involved in the operation of California card clubs? To get to that answer, we must first look at the reason for the prohibition - to keep corruptive and criminal elements out of gaming. If that threat is still legitimate, then we should not do away with the ban and perhaps should even consider tighten the rules for tribal gaming.

The trend in casino gambling, in general, is that publicly traded corporations own and operate casinos. Nevada and New Jersey have regulatory requirements intended to prevent unsuitable persons and financiers from being involved with gambling operations, including those owned by publicly traded corporations. Industry regulators in Nevada and New Jersey report that the gaming industry is less susceptible to having criminal or corruptive elements involved in gambling due to this trend. Publicly traded corporations are motivated by profit and would not jeopardize its investment portfolios by allowing criminal or corruptive elements from becoming involved in its organizations. In addition, publicly traded corporations are more transparent than closely held or closed corporations or companies due to reporting requirements with the Securities and Exchange Commission and recognized exchanges (NYSE, American Stock Exchange, New York Stock Exchange, NASDAQ), so we know more about the publicly traded corporations, its officers, shareholders, dividends, earnings, etc.

So if there is no sound policy reason for the rule or if it is no longer valid, and if the Legislature can institute adequate safeguards to ensure the public’s best interest will not be jeopardized, then it seems reasonable to eliminate the rule.

The additional policy safeguards that should be considered are:

- Allow the Commission, at its discretion, to investigate any owner, officer, or director of the corporation & corporate financial condition
- Build other firewalls to prevent a number of investors with a small amount of shares from taking control of the corporation
- Require renewal every 2 years (NJ - requires it every 4 years, NV - no renewal requirement)
- Need greater disclosure to provide us with the names of all owners

Lifting the prohibition does not appear to have a negative policy implication for the general public or the industry. Removal of the prohibition would not constitute an expansion of gambling. Other state and local prohibitions address that matter, such as Business and Professions Code Sections 19950.2 and 19950.3, which limit the expansion of gambling in California until January 1, 2007.

One question that the Commission is still wrestling with is would a requirement that persons that own five percent or more of the outstanding shares of the publicly traded corporation to be subject to licensure by the state create additional workload for state regulators? Considering these corporations are publicly traded, the percentage of stocks owned by any given investor may vary on a daily basis. The Commission is uncertain at this time what impact this may have on its workload and is investigating this matter.

Bottom line, lifting the restriction would simply give the card club industry financial tools to which they currently don't have access, would make them more viable as an industry, which would be helpful to them and local communities, and would have an additional public benefit of making them less susceptible to criminal or corruptive elements. The Commission is not opposed to removal of this ban.